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PORUGAL: Implications of Presidential Election

Cabinet crises and revolving door governments have been a way of life for Portugal since the Revolution of 1974. The short life-span of most governments--the longest-lived lasted only 25 months--does not reflect sharp divisions over fundamental issues, on which there is a broad consensus among Portugal's non-Communist parties. Democratic Portugal's history of weak and short-lived governments is instead a product of the country's lack of democratic tradition, its multiple party system, and--most important--the highly personalized nature of Portuguese politics. Other complicating factors are a list of economic problems that would test the mettle of even a strong, single-party government, and the existence of an anti-democratic Communist party enjoying the support of almost one in five Portuguese voters. Despite the likelihood of continuing political uncertainty, we think Lisbon's commitment to the Atlantic Alliance will remain strong. Portugal is shifting, however, from an American-oriented diplomacy to a more independent European approach.

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The Winners

The election of the pro-US Socialist leader as Portugal's first civilian president in 60 years put to rest fears of a surge in Communist influence, but is unlikely to end the personal and party differences that have undermined government stability. Soares' backing in the second round of the election by all of the parties of the left conveyed an illusory impression of unity. In fact, only the Socialist Party can be confident of benefitting from his victory.

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The Losers

In contrast, there are many losers, of whom the most conspicuous is outgoing President Ramalho Eanes. Eanes, who has been at odds with Soares since 1978, made the mistake of supporting a Socialist maverick, Salgado Zenha, in the hope of ending Soares' political career and of regrouping the left under his own stewardship. The Soares-Eanes feud has contributed over the years to the institutional conflict which has prevented implementation of any coherent policy program. Eanes' failure has left him with only one way to

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remain active in politics: to take over formal leadership of the shaky left-of-center Democratic Renewal Party, whose creation he quietly encouraged last year. If he does, we expect renewal of the dueling between him and Soares.

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The Communist Party is also reeling from the defeat of Zenha, its first choice for President. The party opted in the runoff to support its arch enemy, Soares, whom the Communists regard as the lesser of two evils compared to conservative Freitas do Amaral. The Communists acted without receiving any commitments from Soares, and the leadership is now under pressure to produce tangible benefits from Soares to satisfy the rank and file. We strongly doubt that Soares will cooperate, and we therefore expect the Communists to revert to obstructionist tactics in the parliament and on the labor front.

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Threats to the Cavaco Silva Government

Prime Minister Cavaco Silva, who leads the Social Democratic minority government, suffered his first major defeat when rightist presidential candidate Freitas do Amaral lost to Soares. Personal animosity is strong between Soares and Cavaco Silva, both because Cavaco Silva brought down the Soares-led coalition government in 1985 by pulling the Social Democrats out, and because Cavaco Silva actively campaigned for Freitas do Amaral in the presidential race. Soares and Cavaco Silva have promised to put aside their differences and focus on Portugal's burgeoning economic and social problems, but Cavaco Silva's confrontational style and Soares' inevitable involvement in foreign policy issues will probably lead to renewed strains between the presidency and the government.

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In short, we think Soares' election has probably made the Cavaco Silva government even more fragile. In addition to the strains between the prime minister and Soares, the government will probably be buffeted by renewed attacks in parliament by the leftist parties. The timing of any challenge will depend on tactical considerations rather than policy issues--on each party's perception of how much it stands to gain or lose from bringing down the government and forcing another early election. Even though the Socialists and the Democratic Renewal will want time to rebuild, we think a minority government could prove too tempting a target.

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Cavaco Silva's government could fall from within, however, if opponents in the party conclude that he is vulnerable. Many party members objected to Cavaco Silva's support for Freitas do Amaral and may take advantage of the opportunity to unseat him if the government suffers setbacks in parliament. Cavaco Silva himself might try to force an early election to take advantage of popular approval for his government's expansionist economic policies and to preempt possible opposition. If his government's economic stimulus program continues to persuade the public that he is correcting some of the ills in the economy, he would be in a strong position to gain seats.

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Prospects for the Economy

Constant political maneuvering over the last eleven years has seriously impeded implementation of effective economic policies. Cavaco Silva now has relaxed the Soares government's austerity program--which improved the current account from a \$3.3 billion deficit in 1982 to a \$100 million surplus last year--and initiated a recovery program aimed at lessening the financial drain of state support for inefficient public enterprises. He is also aiming to reverse the downward trend in private sector investment and real income. The government's measures for 1986 include a four-percentage point cut in domestic interest rates, a series of tax cuts, and a four-month suspension of the monthly 1-percent devaluation of the escudo. The latter is designed to hold down inflation, currently hovering around 19 percent, by containing the cost of imports. Other promised measures include reviving the stock market and revising the rigid labor laws which make it almost impossible to dismiss workers. The government hopes to achieve annual economic growth of 4 percent over the next year.

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Prospects for such a recovery are mixed. We estimate that economic growth will increase slightly over the 1985 rate of 1.8 percent but is not likely to reach the government's expectations. GDP should rise 2.8 percent this year, as real income grows about 1.5 percent and private investment increases by as much as 5 percent. We think inflation will come down to around 15 percent. The government's expansionary policies, however, will probably lead to a current account deficit this year because Portuguese import demand is highly sensitive to changes in income. EC membership is also likely to cause Portugal's

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trade gap to widen as the liberalization of import barriers opens the economy to West European competition and the required shift to higher priced EC agricultural goods increases Portugal's import bill. We would not be surprised if the deficit approaches \$1 billion, which could force the government to seek EC or IMF financial support. Such aid would almost certainly be contingent on another policy reversal--a return to more restrictive economic policies.

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Moreover, the government's present economic policy only partially addresses the fundamental problems plaguing state-owned enterprises which account for 40 percent of domestic borrowing and 95 percent of foreign debt, but only 14 percent of gross domestic product. The promise of turning over much of the huge state sector to private enterprise has been welcomed by the business community. The process of reprivatization, however, will be slow and painful because Cavaco Silva needs the support of parliament to revise the Socialist-oriented constitution. The Socialist Party is likely to be reluctant to support such efforts since their trade union arm is as opposed as the Communist-dominated trade unions to the inevitable layoffs and factory closures. But without major reforms in the mammoth state-controlled sector of the economy, Portugal will not make much headway in its drive to move into the mainstream of modern, industrialized Western Europe.

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Implications for the United States

Despite the likelihood of continuing governmental instability, Portugal will probably not undergo a marked shift to the left or right over the next few years. All of the political elites are committed to the democratic system, and the voters overwhelmingly opt for the moderate and centrist parties. We think Portugal will also remain generally pro-US and a member of the Atlantic Alliance. But the nature of the bilateral relationship with the United States is changing, and Portugal--traditionally among the most cooperative allies--is likely to become a more prickly partner. This is partly a result of Portugal's entry into the EC and partly a result of the growing belief--encouraged by the center-right parties as well as by the left--that Portugal has not been treated fairly by the United States in economic matters or security assistance.

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